Funding Options for Municipalities

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Financing Local Governments

- Need for “hard” services (water, sewers, and roads) and “soft” services (cultural facilities, parks, and libraries) to maintain quality of life

- Local governments that fail to provide these services will lose their economic advantage

- Local governments need adequate revenues to provide services and infrastructure – which revenues?
Outline of Presentation

- Linking revenues and expenditures

- Municipal revenues in Ontario and internationally

- Revenues:
  - Property taxes
  - Income and sales taxes
  - User fees
  - Federal and provincial transfers

- Final observations and key takeaway
Linking Revenues and Expenditures
Linking Revenues to Expenditures

- People want to see what they are getting for their taxes
- Linking taxes and services increases public support
- Examples of ballot initiatives in the US to pay for transit
DIFFERENT SERVICES – DIFFERENT REVENUE TOOLS

Private
Water
Sewers
Garbage
Transit

Public
Police
Fire
Local parks
Street lights

Redistributive
Social assistance
Social housing

Spillovers
Roads/transit
Culture
Social assistance

User fees
Property tax
Sales tax
Income tax
Intergovernmental Transfers
DIFFERENT INFRASTRUCTURE – DIFFERENT FISCAL TOOLS

**Taxes**
- short asset life (police cars, computers)

**User fees**
- identifiable beneficiaries (transit, water)

**Borrowing**
- large scale assets with long life (roads, bridges)
DIFFERENT INFRASTRUCTURE – DIFFERENT FISCAL TOOLS

Development charges
- growth-related costs; new development or redevelopment (water, roads, sewers)

P3s
- large in scale; revenue stream; measurable results (toll roads)

Land value capture taxes
- increase property values (transit)
Municipal Revenues in Canada and Other Countries
Municipal Revenues, Ontario, 2013

- Property Taxes: 41.7%
- User Fees: 19.9%
- Transfers: 21.3%
- Licenses and permits: 2.6%
- Other revenues: 14.4%
Other Municipal Taxes in Selected Provinces

- Land transfer tax
- Amusement taxes
- Hotel taxes
- Poll tax
- Vehicle registration tax
- Billboard tax
- Revenue sharing e.g. fuel tax sharing
International Experience

- More than 80% of local tax revenues from property taxes in Australia, New Zealand, Ireland, United Kingdom, Canada, US

- More than 80% of local tax revenues from personal and corporate income taxes in Sweden, Germany, Switzerland

- Sales taxes are levied mainly by cities in the US

- Mix of taxes in Spain (40% of local tax revenues from sales tax; 30% from property taxes; 20% from income tax and 10% from other)
What Does International Experience Tell Us?

Access to one or more taxes depends on:

- types of expenditures that need to be funded
- local government’s administrative capacity
- willingness of provincial (or central) governments to assign taxes to local governments
- constitutional and legislative requirements
Property Tax – A Good Tax?

- Property is immovable
- Adequate, stable, predictable yield
- Visible/accountable
- Fair - related to benefits received; regressive?
- Residential rates not exported to other jurisdictions
- Minimum inter-municipal competition

- Costly to administer -- arbitrariness of tax base
- Volatile for individual taxpayers
- Inelastic – doesn’t automatically grow with economy
Property Tax – Is It Enough?

- Property tax (2010) yielded 3% or more of GDP in only three OECD countries: Canada, UK, US

- More than 2% of GDP in only four OECD countries: France, Israel, Japan, New Zealand

- Less than 1 percent of GDP in 22 countries

Can Property Taxes be Increased?

![Graph showing the relationship between government revenue and tax rate. The graph is a curve with a peak at T* and R* values.](image-url)
Revenue Hills in GTA Municipalities

- Peak of the revenue hill has not been reached for residential property taxes in most municipalities (some exceptions, e.g. Oshawa)

- Closer to the peak of the revenue hill for non-residential property taxes in some municipalities but some municipalities shifting burden away from non-residential (e.g. Toronto)

Personal Income Tax

- Elastic revenue source

- Taxes commuters if levied on the basis of origin (place of employment)

- Equitable based on ability to pay and benefits received

- Administrative costs low if piggyback onto existing system

But:

- Competition with federal and provincial governments
- Potential for inter-municipal tax competition
- May increase need for equalization
General Sales Tax

- Visible on each transaction
- Elastic revenue source
- Taxes benefits enjoyed by commuters and visitors
- Competition with federal and provincial governments
- Potential for inter-municipal competition if rates set locally **BUT** no way to set differential rates for HST
Excise Taxes

- Examples: hotel occupancy, fuel, vehicle registration, parking

- Some are benefit-related (e.g. vehicle registration tax is related to road use and external effects such as pollution and congestion)

- Can affect consumer behaviour e.g. vehicle taxes reduce automobile purchases; parking taxes reduce congestion
User Fees -- Pricing Services Correctly

- How we pay for services affects our behaviour (e.g. how much water we consume, how much waste we generate)

- Pricing also affects nature, location and density of development

- Local governments need to price services and infrastructure correctly – manage demand for services and infrastructure

- Prevents undesirable income distributional impacts
Federal and Provincial Transfers
Federal and Provincial Transfers

- Equalization and grants to address spillovers are important but:
  - break the link between those who benefit and those who pay
  - not stable and predictable funding (depends on resources available)
  - no incentive to use proper pricing
  - conditional transfers distort local decision-making
  - accountability problems with conditional transfers when two or more levels of government fund the same service
Final Observations and Takeaway
Final Observations

- User fees should fund services where beneficiaries can be identified e.g. water, sewers, waste collection, transit, roads

- Local taxes – and possibly a range of taxes -- should fund services that provide collective benefits to the local community

- Intergovernmental transfers should be used for equalization, spillovers
Final Takeaway

- To ensure public goods meet preferences of beneficiaries and taxpayers and to improve responsiveness and accountability of local governments, it is important to link:

  - those who decide
  - those who benefit
  - those who pay